

Audit Report
Sakhisizwe Municipality
For the Year ended 30 June 2011

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON SAKHISIZWE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Sakhisizwe Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010) (DoRA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

7. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose material irregular expenditure that occurred during the financial year. Audited payments amounting to R5,4 million were irregular as they were made in contravention of the supply chain management (SCM) requirements. These amounts were not included in the irregular expenditure disclosed in note 43 to the financial statements. Consequently, the irregular expenditure disclosed is understated by at least this amount. However, it was not practicable to determine the full extent of the understatement as there was no system of control to identify all irregular expenditure incurred.

Commitments

8. The municipality is required by GRAP 17 *Property, Plant and Equipment* to disclose in the financial statements the amount of contractual commitments for the acquisition of property, plant and equipment at the financial year-end. The municipality did not have a contract management system for the identification and recognition of contracts and consequently did not disclose any commitments. I was unable to confirm or verify by alternative means the contractual commitments for the acquisition of property, plant and equipment and, as a result, I was unable to determine the commitments to be disclosed in the financial statements.

Leave accrual

9. The entity could not provide sufficient appropriate audit evidence to support employee leave accrual balances. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all leave amounting to R914 486 had been properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and completeness of the leave accrual amounting to R1,5 million, as reported in note 14 to the financial statements.

Qualified opinion

10. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Sakhisizwe Local Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

11. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Unauthorised expenditure

12. As reported in note 41 to the financial statements, the municipality incurred unauthorised expenditure amounting to R4 million, which was as a result of exceeding the total amount of the budget for the year.

Irregular expenditure

13. As reported in note 43 to the financial statements, the municipality incurred irregular expenditure amounting to R19,5 million, as the expenditure incurred was in contravention of the SCM process.

Fruitless and wasteful expenditure

14. As reported in note 42 to the financial statements, the municipality incurred fruitless and wasteful expenditure amounting to R39 146, due to duplicate payments to creditors.

Material impairments

15. As reported in note 9 to the financial statements, the municipality had material impairments totalling R2,25 million related to receivables not considered recoverable.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

16. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

Presentation of information

17. The following criterion is relevant to the findings below:
 - Performance against predetermined objectives is reported using the National Treasury guidelines.

18. Audit findings

- Adequate explanations for major variances between the planned and actual reported targets for the following development priorities were not provided, as required in terms of the relevant reporting guidance. In total, 100% of the reported targets with major variances were not explained.
 - Local economic development
 - Service delivery
 - Municipal transformation and institutional development
 - Financial management and viability
 - Good governance and public participation
- In terms of the relevant reporting guidance, when performance is not met, the measures to be taken to improve this performance must be disclosed in the annual performance report. In total, 100% of the reported targets, where planned performance was not met, did not include adequate disclosure of the measures to improve this performance.

Usefulness of information

19. The following criteria are relevant to the findings below:
 - **Relevance:** A clear and logical link exists between the objectives, outcomes, outputs, indicators and performance targets.

- Measurability: Indicators are well defined and verifiable, and targets are specific, measurable and time bound.

20. Audit findings

- The indicator and targets as per the integrated development plan did not relate directly in more than 24% of instances to the institution's strategic goals and objectives as per the annual strategic development budget implementation plan.
- The indicator and targets as per the annual performance report did not relate directly in more than 57% of instances to the institution's strategic goals and objectives as per the annual strategic development budget implementation plan.
- A total of 49% of the planned and reported indicators were not well defined, as unambiguous data definitions were not available to allow for data to be collected consistently.
- Valid performance management processes and systems that produce actual performance against the planned indicators did not exist for 57% of the indicators.
- A total of 46% of the planned and reported targets were not specific in clearly identifying the nature and the required level of performance by the municipality.
- A total of 89% of the planned and reported targets were not measurable in identifying the required performance by the municipality.
- A total of 86% of the planned and reported targets were not time bound in specifying the time period or deadline for delivery.

Reliability of information

21. The following criteria are relevant to the findings below:

- Validity: Actual reported performance has occurred and pertains to the entity.
- Accuracy: Amounts, numbers and other data relating to reported actual performance have been recorded and reported appropriately.
- Completeness: All actual results and events that should have been recorded have been included in the annual performance report.

22. Audit findings

- Sufficient appropriate evidence in relation to the selected objectives for usefulness could not be obtained from the municipality. There were no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported performance against predetermined objectives.

Compliance with laws and regulations

Strategic planning and performance management

23. The municipality did not implement a framework that described and represented how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement would be conducted, organised and managed, including determining the roles of the different role players, as required by sections 38, 39, 40 and 41 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) read with Municipal Planning and Performance Management (MPPM) Regulations 7, 8 and 9.
24. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the

municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72(1)(a)(ii) of the MFMA.

Budgets

25. The mayor did not submit all quarterly reports to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
26. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance report and annual report

27. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements in current assets, liabilities, revenue and expenditure identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
28. The accounting officer did not make the 2009-10 annual report public immediately after the annual report was tabled in the council, as required by section 127(5) of the MFMA.
29. The municipal council did not adopt an oversight report containing the council's comments on the annual report within two months from the date on which the 2009-10 annual report was tabled in the council, as required by section 129(1) of the MFMA.

Audit committee

30. The audit committee functioning as the performance audit committee did not perform the following as required by MPPM Regulation 14:
 - Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality.
 - Review the municipality's performance management system and make recommendations in this regard to the council of the municipality.
 - Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

Procurement and contract management

31. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as per the requirements of SCM Regulation 17(a) and (c).
32. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM Regulations 19(a) and 36(1).
33. Awards were made to providers whose tax matters had not been declared to be in order by the South African Revenue Service, as required by SCM Regulation 43.
34. Awards were made to suppliers that did not submit a declaration on their employment by the state or their relationship to a person employed by the state, as per the requirements of SCM Regulation 13(c).
35. The preference point system was not applied in all procurement of goods and services

above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and SCM Regulation 28(1)(a).

36. Awards were made to suppliers based on preference points that had not been allocated or calculated in accordance with the requirements of the PPPFA and its regulations.
37. Awards were made to suppliers that did not score the highest points in the evaluation process, contrary to the requirements of section 2(1)(f) of the PPPFA.
38. The performance of contractors and providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
39. The contract performance measures and the methods whereby they are monitored were insufficient to ensure effective contract management, as per the requirements of section 116(2)(c) of the MFMA.
40. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) in accordance with the prescripts of the CIDB.
41. Awards were made to providers whose directors or principal shareholders are persons in the service of other state institutions, in contravention of the requirements of SCM Regulation 44.

Expenditure management

42. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, contrary to section 65(2)(e) of the MFMA.
43. The accounting officer did not take reasonable steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

INTERNAL CONTROL

44. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

45. There was a lack of oversight and accountability by senior management, as sufficient monitoring controls were not in place to ensure the proper implementation of approved internal policies and procedures at an operational level. Thus, the necessary awareness required to enable the taking of appropriate corrective actions where actual processes were not aligned to the approved processes either through intentional or other circumvention was not evident.
46. As a result, the municipality did not prevent and detect irregular expenditure incurred through non-adherence to the SCM prescripts. In addition, the documented policy and procedure manuals for reporting on predetermined objectives were not implemented. Consequently, the reporting on predetermined objectives was not useful and verifiable.
47. However, following the successful implementation of the audit action plan, the leadership was able to adequately address a number of qualifications previously reported relating to

balances, disclosures and classes of transaction reported in the financial statements. A similar approach for the current year will ensure an improved outcome.

Financial and performance management

48. The municipality did not have adequate systems for the complete and accurate financial reporting of commitments, irregular expenditure and the leave accrual balance. This is as a result of inadequate in-year monitoring of expense transactions to ensure that SCM requirements were fully adhered to. Attendance registers were not always completed and the leave system was not kept up to date, resulting in the need to rely on manual leave records. No commitments register was maintained and thus the municipality was not able to report a balance for the year under review.
49. In addition to the system weaknesses relating to the accounting for leave, irregular expenditure (SCM) and reporting on predetermined objectives above, not all documentation requested was provided for audit purposes, indicating poor record keeping.
50. The municipality did not adequately assign responsibility and implement processes to monitor compliance with the approved budget and ensure compliance with all applicable laws and regulations. The municipality thus incurred unauthorised expenditure and did not fully comply with all the requirements of the MFMA, the MSA, MPPM Regulations, the PPPFA and SCM Regulations.

Governance

51. Despite an adequate risk assessment process, the municipality did not respond to and adequately monitor the risks identified. As a result, there were numerous instances of non-compliance with the MFMA, the MSA, the PPPFA as well as SCM and MPPM Regulations.
52. The performance audit committee and the internal audit function did not have the necessary capacity to review or report on the performance management system or performance reports during the year under review. The municipality thus lost the benefit that may have been obtained had these reports been completed.

Auditor - General

East London

30 November 2011



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence